

This letter discusses the taxability of sale/leaseback situations. See 86 Ill. Adm. Code 130.220. (This is a GIL.)

September 26, 2006

Dear Xxxxx:

This letter is in response to your letter dated June 1, 2006, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

This letter is to request a General Information Letter regarding the taxability (sales/use/retailers occupational) of a sale/leaseback of school buses.

Facts

Company A is a for profit company that contracts with school districts to provide bus services for children. Company A purchases these school buses in Illinois. Company A pays sales tax on the purchase of these buses and remits it to the Illinois Department of Revenue, along with the appropriate RUT-25 Motor Vehicle Use Tax Return, before the first functional use of the buses and within 90 days of the original purchase.

Shortly after the purchase of the buses, Company A executes a sale/leaseback on the buses that contains a seven (7) year lease term. Along with the monthly lease payments, Company A remits to the City of Chicago its six percent (6%) Personal Property Lease Transaction Tax 7550. Pursuant to the terms of the lease, the final payment is a mandatory balloon payment equal to twenty percent (20%) of the original purchase price of the buses. After the last payment is made, the lien holder releases the lien and Company A owns the buses free and clear of any encumbrances. No buyout or nominal fees are required.

Law

State of Illinois

Pursuant to ST 97-0097-GIL, the first transaction (the sale from the bus retailer to Company A) is a taxable retail sale. The second transaction (the sale from Company A to the lessor) is a nontaxable occasional sale, so long as the users are not otherwise engaged in the business of selling like-kind property. The third transaction (the leaseback of the buses by Company A from the lessor) is not a taxable event because Illinois does not impose sales tax liability on rental receipts.

City of Chicago

Pursuant to Chapter 3-32-020(H) Chicago Personal Property Lease Transaction Tax, the words 'lease' or 'rental' shall not be construed to include an agreement, which constitutes a bona fide conditional sale of personal property. The primary consideration in determining whether an agreement is a conditional sale rather than a lease or rental is whether the lessee under the agreement both is required to make payments the sum of which is at least equal to the lessor's cost of the personal property and, under the terms of the agreement, has the option of taking title to or ownership of the personal property for a nominal or no consideration after all payments required under the agreement have been made.

Comments

According to the City of Chicago, the above-described bus transaction is not a lease or rental, but rather a conditional sale of personal property and therefore exempt from the City of Chicago's Personal Property Lease Transaction Tax 7550. However, the State of Illinois defines the identical transaction as a sale/leaseback. As such, sales tax is due on the initial purchase of the buses (along with the appropriate RUT-25 Return); the sale from Company A to the lessor is a nontaxable occasional sale; and the leaseback of the buses by Company A from the lessor is a nontaxable rental receipt.

Issue

We have requested a refund of the Personal Property Lease Transaction Tax 7550 from the bank (lien holder). To date, the bank has been reluctant to refund the overpaid monies expressing concern that if the City of Chicago defines the transaction as a conditional sale, then by default the State of Illinois must also define it as a conditional sale.

Requested Clarification

- (1) Please confirm that the State taxes on the above-described transaction were correctly paid.
- (2) Please confirm that the State of Illinois is not bound by an interpretation promulgated by the City of Chicago, but may freely to [sic] interpret the same transaction as it sees fit.

Please send your response to:

NAME/ADDRESS

Thank you for your time and assistance in this matter. If you have any questions or need additional information, please contact me.

DEPARTMENT'S RESPONSE

As you are aware, the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. See 86 Ill. Adm. Code 130.220. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability. The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

Without seeing any of the leasing documents involved, we cannot tell for sure whether the leaseback of the buses by Company A from the lessor is a true lease or a conditional sale. However, from your description of the transaction, the seven-year lease may be a conditional sale.

A sale/leaseback transaction is not generally used with a conditional sale transaction because there is no statutory mechanism to provide a credit for tax previously paid by the users. Ultimately if a sale/leaseback is used in conjunction with a conditional sale, the users will be liable for tax when the item is purchased and again when the lessors conditionally sell the equipment back to the users. To avoid this result the users would need to lease the equipment from the lessors under a true lease rather than a conditional sale.

We noticed that you purchase school buses in Illinois. You then remit tax on a RUT-25 Use Tax Transaction Return "before the first functional use of the buses and within 90 days of the original purchase." We are not sure what the situation is, but we want to provide you with the following information.

The ST-556 is generally used by retailers that sell motor vehicles at retail in Illinois. Motor vehicles that must be reported on Form ST-556 include cars, trucks, vans, motorcycles, ATVs, buses, watercraft, aircraft, motor homes, trailers, snow mobiles, and mobiles homes. Form ST-556 and any tax payment are due within 20 days of the date of delivery of the motor vehicle.

The RUT-25 is generally filed by a motor vehicle owner when the owner purchased the item from or moved into Illinois with a motor vehicle that was previously purchased from an out-of-state dealer, lending institution, leasing company selling at retail, or retailer, and is titled or registering the

item in Illinois. Form RUT-25 and any tax payment are due within 30 days of the date the motor vehicle is brought into Illinois.

For more information regarding Illinois vehicle taxes, we refer you to the Department's publication STS-76, "Illinois Vehicle Tax Information Guide."

We are unable to assist you in regard to any issues regarding the definition of terms under the Chicago Personal Property Lease Transaction Tax. The Department of Revenue administers the State sales tax. The City of Chicago under completely different statutes administers the Chicago Personal Property Lease Transaction Tax.

If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote
Associate Counsel

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